June 13, 1997

The Honorable Alice M. Rivlin
Vice Chair, Administrative Governor, and Budget Committee Chair

The Board Budget Committee's April 25, 1997, memorandum asked each division and office director a number of broad questions about planned resource usage over the next four years and directed them to pay particular attention to possible savings that might accrue to the Board if activities were carried out in another division, the Reserve Banks, another agency, or by an outside vendor. During our audit scoping effort of the Board's fixed assets management process, we identified a distributed processing procurement strategy being used successfully in the private sector that is also being considered for the federal government. We believe adoption of this strategy could save the Board money, provide a higher degree of budget control and predictability, and improve the quality of end-user automation services. Its key elements are described below followed by a summary of the Board's current distributed processing procurement practices and resulting operating environment.

Acquiring Distributed Processing Services on a Per-Seat Basis

The private sector has increasingly found it to be more advantageous to buy complete distributed processing "services" rather than to purchase hardware and software and use internal staff to provide training, software maintenance, and technical support. For one comprehensive price, users can have access to a full range of desktop services, including consulting, hardware and software procurement, maintenance, training, and system administration. The pricing of these automation services is often calculated on a "per-seat" basis — a seat representing one workstation or one end user. It is essentially a lease arrangement for hardware and software which includes support for attendant services. The total contract price per seat is dependent on the terms and conditions of the negotiated contract and may include regularly scheduled hardware and software upgrades.

The Gartner Group (an information technology consulting firm) believes that within a few years, half of all information system departments will contract with outside vendors to provide one or more of their major end-user computing functions. Gartner also estimates that half of all desktop service contracts will be built around per-seat pricing, some of which will be tiered to reflect different support requirements within an organization or department. This growing trend toward buying services instead of purchasing and supporting hardware and software stems from lower overall costs, fixed prices that are easy to budget, improved automation services, greater flexibility to deal with accelerating obsolescence of personal computers and software, access to

highly skilled technicians that would otherwise be lost because of salary constraints, and freedom for senior managers to focus more on core missions and objectives.

In the public sector, the General Services Administration (GSA) is working on a "seat management" plan that will encourage government agencies to identify all of their costs and to lease desktop tools and services. GSA believes that government agencies have tremendous hidden costs in maintaining desktop computer infrastructures that need to be factored in when evaluating and comparing procurement options. GSA has the tacit approval of the Office of Management and Budget to proceed with its seat management strategy.

The Board's Current Procurement Strategy

Currently, the Board purchases nearly all of its distributed processing hardware and software, and staff analyses of procurement options, when performed, have focused on decisions of whether to purchase or lease computer hardware. This strategy has contributed to distributed processing operating costs at the Board increasing at an average annual rate of more than 14 percent a year. Although distributed processing costs historically have not been segregated or tracked in the Board's accounting systems, the performance report and other data provided by Board budget staff indicate that in 1996 the Board's distributed operating costs were approximately $12 million (this includes depreciation on computer hardware). With an estimated 1600 workstations or "seats" at the Board, per seat operating expense is approximately $7,500 per year.

In addition to escalating costs, the practice at the Board of spreading purchases over several years coupled with shorter and shorter technology life cycles has created mismatched, and occasionally incompatible hardware and software configurations that have contributed to divisions experiencing document and data sharing and interconnectivity problems — especially across divisions. Also, purchasing hardware and software requires administrative processes to be established for inventory management and accounting, and at the Board, these processes have encountered problems such as inaccurate property management data, duplicative tracking systems, and difficulties disposing of surplus equipment, which add to the administrative costs of the Board. Overall, it appears that using outside providers of distributed processing services could lower costs, simplify budget planning with per-seat pricing, and reduce technological obsolescence as well as connectivity and administrative problems.

A More In-Depth Analysis Needs to Be Performed

Notwithstanding our belief that this per-seat distributed services procurement strategy has merit, we have not performed the in-depth benefit-cost analysis that would be needed to make such a strategic decision because complete cost data is not readily available, and when prepared, will need to be compared with vendor proposals. Nevertheless, we believe that the merits of buying distributed automation services on a per-seat basis warrant further analysis, perhaps by the Staff Planning Group or a leading information technology consulting firm commissioned to provide a comprehensive study. Such a study would need to be a holistic analysis of hard and soft costs incurred in all divisions at the Board. Existing cost estimates do not include, for example, the salaries and benefits of all technology staff in the user divisions or a portion of the property management staff, or the costs of recruiting in-house specialists, and storing and disposing of hardware and software. "Total cost of ownership" models would help provide accurate cost data for each major functional area of distributed processing that would be necessary to compare in-house versus outsourced services. In addition to costs, it will also be important to develop an accurate number of workstation seats at the Board to be used in the development of a request for proposal for vendor bids to compare approaches, staff skill sets, proposed services and service levels, and costs with existing costs and services.
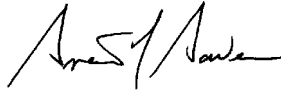
Termination of Our Audit Scoping Effort

In addition to reviewing the Board's procurement of end-user computing during our scoping of the Board's fixed assets management processes, we also analyzed and issued comments to the Board's Controller on a staff proposal to increase the fixed assets capitalization / depreciation threshold (we suggest a $10,000 threshold instead of the $5,000 recently proposed). We also commented that proposed physical inventories of property items should not be tied solely to a capitalization / depreciation materiality threshold but to other business reasons for managing and tracking lower cost property items — particularly, those assets vulnerable to theft or loss such as antiques, historical office furniture, artwork, and personal computers. Further, we also suggested that the staff explore opportunities to reduce the administrative burden of periodically reconciling the mainframe-based property management system to the Board's general ledger. The Controller and his staff are considering our suggestions.

Given the outstanding policy issues and possible changing priorities of the ASAP project, we have decided to defer our scheduled business process review of fixed assets to a later date. In the meantime, we plan to monitor and evaluate staff initiatives or studies aimed

at improving procurement, accounting, and property management processes. We are available to discuss our review effort and ideas for future work with you or your designee(s).

Sincerely,

Brent L Bowen
Inspector General

cc: Governor Kelley
     Governor Phillips
     Mr. S. David Frost
     Mr. Robert E. Frazier
     Mr. George E. Livingston
     Mr. Stephen R. Malphrus
     Mr. Barry R. Snyder
     Ms. Patricia Kelley
     Mr. Stan Weidman